

REPORT OF EXAMINATION
KITSAP PHYSICIANS SERVICE

Bremerton, Washington

As of December 31, 1997



Participating States:
Washington

Kitsap Physicians Service

CHIEF EXAMINER AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of KITSAP PHYSICIANS SERVICE of Bremerton, Washington. This report shows the financial condition and related corporate matters as of December 31, 1997.

James T. Odiorne, CPA, JD
Deputy Commissioner for Company Supervision
Acting Chief Examiner

Kitsap Physicians Service

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Kitsap Physicians Service

Lacey, Washington
October 16, 1998

The Honorable Deborah Senn, Commissioner
Washington Department of Insurance
Insurance Building
P.O. Box 40255
Olympia, WA 98504-0255

Dear Commissioner Senn:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.44.145, an examination was made of the corporate affairs and financial records of

KITSAP PHYSICIANS SERVICE

of

Bremerton, Washington

hereinafter referred to as "KPS" or the "Company," at its home office located at 400 Warren Avenue, Bremerton, Washington 98337. This report is respectfully submitted showing the condition of the Company as of December 31, 1997.

SCOPE

This examination covers the period January 1, 1995, through December 31, 1997, and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements of Title 48 Revised Code of Washington (RCW), Title 284 Washington Administrative Code (WAC) and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination. Additionally, the examiners reviewed and utilized the work papers prepared by the Company's independent auditors to the extent possible.

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INSTRUCTIONS

The examiners reviewed the Company's filed 1997 Annual Statement as part of the statutory examination. The review focused on determining if the Company's Annual Statement was completed in accordance with the Annual Statement Instructions published by the NAIC. The following summarizes the exceptions noted while performing this review. The Company is instructed to correct and comply in future Annual Statement filings, per RCW 48.44.095.

1. Indemnity account

The Company is instructed to:

- a. Deposit additional funds in the Indemnity Account so that the balance of securities in trust with the Office of Insurance Commissioner (OIC) complies with the statutorily required indemnity level required by RCW 48.44.030.
- b. Obtain joint written instructions from the Commissioner and Company for all withdrawals of deposits from the Indemnity Account, as outlined by the Depository Agreement.

2. Common stocks

The Company is instructed to non-admit the portion of its investments that exceeds the 4% limitation established by RCW 48.13.270(3), until a special consent is issued by the Commissioner.

3. Safekeeping agreements

The Company is instructed to:

- a. Revise its custodial agreements to include the required provisions for indemnifying the Company for lost securities as promulgated by NAIC guidelines, RCW 48.44.095 and WAC 284-07-050.
- b. Place the securities held in the custody of the brokerage firms into the custody of a bank, trust company or a security depository that is regulated by the Securities Exchange Commission and the Federal Reserve Board as promulgated by NAIC guidelines, RCW 48.44.095 and WAC 284-07-050.

4. Uncollected premiums

The Company is instructed to exclude premiums delinquent more than ninety (90) days as admitted assets, as required by RCW 48.12.010(5).

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5. Electronic data processing equipment

The Company is instructed to exclude furniture, furnishings, fixtures, equipment, stationary and supplies from its reported balance of Electronic data processing equipment as an admitted assets as required by RCW's 48.12.010(11) and 48.12.020(5).

6. Aggregate write-ins for other than invested assets Westsound Community Health Network

The Company is instructed to value its investment in Westsound Community Health Network on a Statutory Accounting Principles (SAP) basis, excluding the value of assets that do not constitute lawful investments, as required by Section 5(B)(a)(i) of the NAIC Securities Valuation Office's Instructions and Procedures Manual and RCW's 48.12.010(11) and 48.12.020(2).

7. Aggregate write-ins for other than invested assets Miscellaneous receivable

The Company is instructed to non-admit employee advances as required by RCW 48.12.020(3).

8. Other expenses due or accrued Accounts payable

The Company is instructed to report all expenses and other obligations as a liability as required by RCW 48.12.030(5) and NAIC Annual Statement Instructions.

9. Other expenses due or accrued COB savings liability

The Company is instructed to keep timely and complete reconciliations of its general ledger accounts and to keep full and adequate accounts and records of its assets, obligations, transactions and affairs, as required by RCW 48.44.100. The accounts and records required by RCW 48.44.100 include any liability for COB Savings generated under the provisions of Chapter 284.51 WAC.

10. Aggregate write-ins for reserves and other funds Unrealized gains on stocks

The Company is instructed to accurately report the unrealized gains on stocks within Annual Statement Schedule D - Part 2 - Section 2 and on the Liabilities, Reserves & Other Funds schedule - Line 18. The NAIC Annual Statement Instructions requires that the amounts reported within these schedules to be equal.

Kitsap Physicians Service

11. Aggregate write-ins for reserves and other funds Deferred compensation plan - Fund A

The Company is instructed to:

- a. Equally value the asset valuation of Deferred Compensation Plan - Plan A and the offsetting liability valuation, with no effect to surplus.
- b. Report Deferred Compensation Plan - Fund A on Line 14 - 'Aggregate Write-Ins For Liabilities' as a liability, as required by the NAIC Annual Statement Instructions and RCW 48.12.030(6).

RECOMMENDATIONS

The examination developed the following comments or recommendations calculated to prevent non-compliance in the future.

1. Investment policy

The Company's Investment Policy includes two (2) clauses that could potentially place the Company in violation of certain provisions of Title 48 Revised Code of Washington. It is recommended:

- C The asset concentration clause be revised to comply with the 4% of admitted assets limitation as set forth by RCW 48.13.030.
- C The Trust Funds clause be revised to indicate that deposits may not be withdrawn and distributed to the Company without joint written instructions from the Commissioner and KPS per the terms of the Depository Agreement.

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2. Amounts receivable relating to uninsured accident and health plans

It is recommended that receivables and payables relating to uninsured accident and health plans be reported separately as required by the NAIC Annual Statement Instructions.

3. Underwriting and Investment Exhibit - Part 4A

It is recommended that the Company accurately report the change in Unrealized Gain of Stocks in the Underwriting and Investment Exhibit Part 4A, Column 5 - 'Net Gain Or (Loss) From Change In Difference Between Book And Admitted Values for Common Stocks' as required by the NAIC Annual Statement Instructions.

4. Intercompany agreement

It is recommended that KPS draft a written intercompany agreement with Westsound Community Health Network describing services rendered and the reimbursement methodology for those services.

5. Disaster recovery plan

It is recommended that the Company write and test for effectiveness a Disaster Recovery Plan for its EDP system that includes appropriate escalation procedures to resolve operational failures in a timely manner, as promulgated by NAIC Guidelines.

6. Business contingency plan

It is recommended that the Company prepare a Business Contingency Plan that addresses the continuation of all significant business activities, including financial functions, telecommunication services and data processing services, in the event of a disruption of normal business activities, as promulgated by NAIC Guidelines.

Kitsap Physicians Service

HISTORY

The Company was incorporated on January 5, 1934, as a Washington Corporation under the name of Kitsap County Medical-Dental Business Bureau. The Company received its original Certificate of Registration from the Office of Insurance Commissioner on September 5, 1947, and was licensed to transact medical health care business. The Company went through a transitional period during which the Company incorporated several affiliate companies, merged with these companies and changed its name several times. On October 23, 1960, the Company changed its name to Kitsap Physicians Service.

On May 19, 1965, KPS merged with Mason County Medical Service Corporation. On December 24, 1975, KPS merged with Jefferson County Medical Service Corporation. In May 1984, KPS purchased all of the outstanding stock of Kitsap Administrative Services, Inc., a data processing service Corporation. In March 1994, Harrison Memorial Hospital (HMH) and KPS teamed together to form Westsound Community Health Network (WCHN), a non-profit Physician Hospital Organization. KPS has a 50% ownership of the subsidiary company.

KPS covers approximately 80,000 enrollees and the service area includes Jefferson, Kitsap, Mason and Thurston Counties.

MEMBER PHYSICIANS

Kitsap Physicians Service has one (1) class of Member Physicians. The eligibility requirements for being an admitted Member Physician of KPS are:

- i. Be licensed as a Medical Doctor or Doctor of Osteopathy in the State of Washington;
- ii. Conduct substantially all of his/her practice in Kitsap, Mason and/or Jefferson counties;
- iii. Satisfy such other membership eligibility criteria as may be approved from time to time by the corporation's Board of Directors;

Each Member Physician is entitled to one (1) vote on each matter submitted to a vote of the members.

MANAGEMENT

The management of all the affairs, property and interest of Kitsap Physicians Service is vested in a Board of Directors consisting of nine (9) members, six (6) of whom are physician directors and three (3) of whom are non-physician directors. Member physicians are limited to practicing physicians and surgeons who conduct their major practice in Kitsap, Mason and Jefferson counties and who have a current Participating Physician's Agreement with KPS to provide medical services to its subscribers.

Kitsap Physicians Service

The President and Chief Executive Officer of KPS is Robert C. Schneidler, who exercises general management and direction of KPS and has all of the powers ordinarily exercised by the president of a corporation.

The following directors and officers are serving the Company as of December 31, 1997:

Officers:

Robert Carlton Schneidler	President and Chief Executive Officer
Deryl Brown-Archie	Secretary, General Counsel
Melvin Earl Belding, MD	Sr. Vice President - Medical Affairs, Medical Director
Laura Jayne Wallace	Sr. Vice President - Operations
Willis James Page	Vice President - Finance, Treasurer

Directors:

<u>Name</u>	<u>Principal Occupation</u>
Mark Charles Adams, MD	Thoracic/Vascular Surgeon
Robert Lee Caulkins, MD	Family Practitioner/Obstetrician
James Thomas Clemen, MD	General Surgeon
Ronald Corcoran	Federal Employee
Sloan Myers	Self-Employed, Co-owner Boxlight Corporation
Robert Rankin, MD	Family Practice/Obstetrics
Pankaj Sharma, MD	Gastroenterologist
Richard Bruce Wesley, MD	Pulmonary Medicine/Internal Medicine
Paul William Zellinsky, Sr.	Washington State House of Representatives

AFFILIATED COMPANIES

Westsound Community Health Network

A subsidiary company of Kitsap Physicians Service. Westsound Community Health Network (WCHN) is a non-profit Physician Hospital Organization, created during March 1994, as a joint venture with Harrison Memorial Hospital (HMH). WCHN functions as a community based, integrated health care delivery system. KPS and HMH each contributed \$50,000 as initial capitalization and each owns 50% of WCHN. The Company's total investment in WCHN as of the examination date is \$540,000. The audited valuation of WCHN is \$135,009, for an unrealized loss of \$404,991. During March 1998, the Board of Directors reached a consensus that, for various reasons, KPS could no longer continue its financial support of WCHN and passed the following resolution:

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BE IT RESOLVED THAT the Board directs staff to notify Harrison Memorial Hospital that KPS will no longer fund WCHN.

As a direct result of the above resolution, the Board of WCHN held a meeting in May 1998 to discuss its direction for the future. WCHN anticipates some form of reorganization in order to sustain its current programs.

Westsound Community Health Network has a staff of four (4) employees. KPS performs all of the accounting functions for WCHN, which includes accounts payable, payroll, accounts receivable, general ledger reports and monthly financial statements. During the examination period, KPS did not receive any reimbursement from WCHN for these services. Starting in January 1998, KPS began receiving \$200 per month from WCHN as reimbursement for these accounting services.

Kitsap Physicians Service and WCHN do not have a formal written Intercompany Agreement that specifically identifies the services that are to be provided, the amount of reimbursement that is to be paid for those services, the payment due date and the period of time the agreement is to be in effect. Such agreement should be signed by officers of both companies. (See Recommendations No. 4).

Kitsap Physicians Service valued WCHN using the Generally Accepted Accounting Principles (GAAP) equity basis. Section 5(B)(a)(i) of the NAIC Securities Valuation Office's Instructions and Procedures Manual states "a non-insurance company owned by an insurer shall have an Association Value determined on the value of only such of the assets of such company as would constitute lawful investments for the insurer if acquired or held directly by the insurer." The valuation of WCHN was not adjusted from a GAAP to SAP basis and included prepaid insurance, prepaid expenses and equipment acquired for an Internet and Intranet project. RCW 48.12.020(2) expressly classifies prepaid charges for expenses as non-admitted assets. RCW 48.12.010(11) does classify electronic and mechanical machines constituting a data processing and accounting system as an admitted asset. However, since KPS provides all accounting functions for WCHN, the equipment acquired for the Internet and Intranet project do not constitute an accounting system and are considered to be a non-admitted asset. These non-admitted assets should not be included in the valuation of WCHN when adjusting the value from a GAAP to SAP basis. (See Instructions No. 6).

RESERVES AND OTHER FUNDS

Statutory Minimum Net Worth

RCW 48.44.037 requires every health care service contractor to maintain a minimum net worth equal to the greater of:

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- i. Three million dollars;
- ii. Two percent of the annual premium earned on the first one hundred fifty million dollars of premium and one percent of the annual premium in excess of one hundred fifty million dollars.

During 1997, the annual premium earned was \$97,394,664. At two percent, the required minimum net worth is equal to \$1,947,893. As of the examination date, the audited net worth of KPS was \$6,469,709, exceeding the required minimum.

Statutory Indemnity Account

Along with its 1997 Annual Statement, KPS filed Form IC-13A-IC with the Office of Insurance Commissioner, which calculated the statutory required indemnity balance to be \$5,719,673.

RCW 48.44.030 requires the Company to place in joint custody with OIC a deposit consisting of securities and/or cash equal to the statutory required indemnity. The balance of the Indemnity Account was confirmed as of the examination date and the account balance was found to be in compliance with the statutory requirement set forth in RCW 48.44.030.

However, during First Quarter 1998, two (2) bonds with an approximate value of \$380,000 were called and the proceeds were withdrawn from the Indemnity Account by the Company without joint written instructions from the Commissioner and KPS. The withdrawal lowered the deposit balance below the statutory required indemnity level set forth in RCW 48.44.030. (See Instructions No. 1).

Unrealized Gain On Stocks

RCW 48.12.180 states that common stocks are to be valued at their market value. A special reserve fund is maintained to identify the unrealized gain on common stocks. The reserve balance was reported correctly by KPS in the 1995 Annual Statement. However, the reserve balance reported in the 1996 and 1997 Annual Statements did not agree with the unrealized gain on stocks as reported in Schedule D - Part 2 - Section 2. These amounts should agree, per NAIC Annual Statement Instructions. (See Instructions No. 10).

Deferred Compensation Plan - Fund A

Kitsap Physicians Service entered into a deferred compensation plan (Fund A) with physicians who met the criteria of eligibility. Fund A allowed physicians to defer, on a tax free basis, a portion of the claim reimbursement due them from medical services rendered to KPS subscribers. The monies invested in Fund A earn a minimum investment yield and upon retirement, the participating physician receives monthly payments for a specified period until their portion of Fund A is expended. The admitted balance of Fund A was confirmed at \$1,247,797 as of the examination date.

The asset valuation of Fund A was correctly valued, but the offsetting liability valuation was

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reported at \$1,170,375, for a difference of \$77,422, which was included in the Unassigned Funds reserve. The asset and liability valuations should be equal, offsetting each other, with no effect to surplus. (See Instructions No. 11a).

The liability valuation of Fund A is reported by the Company on Line 18 - 'Aggregate Write-Ins for Reserves And Other Funds' as a special reserve fund. The NAIC Annual Statement Instructions require postretirement obligations to be reported on Line 14 - 'Aggregate Write-ins For other Liabilities' as a liability. RCW 48.12.030(6) states that liabilities to be charged against the assets shall include any additional reserve set up by the insurer for a specific liability purpose or required by the Commissioner consistent with practices adopted or approved by the NAIC. (See Instructions No. 11b).

CORPORATE RECORDS

The examiners reviewed the corporate records of Kitsap Physicians Service for the period under examination. All Board meetings were conducted with a quorum present. The Board members ratified all changes to the Articles of Incorporation and Bylaws.

ACCOUNTING RECORDS AND PROCEDURES

The Company maintains its accounting records on a GAAP modified accrual basis of accounting and adjusts to SAP basis for Annual Statement reporting. The Company is audited annually by the Certified Public Accountants, KPMG Peat Marwick, LLP. An unqualified opinion was issued for each year in the examination period.

The Annual Statements filed with the Office of Insurance Commissioner during the examination period were examined and reviewed to verify that they were prepared in a manner consistent with the statutory requirements of Title 48 Revised Code of Washington, Title 284 Washington Administrative Code, the standards and procedures required or prescribed by the Washington Office of Insurance Commissioner and the National Association of Insurance Commissioners. The following areas deviated from these standards and procedures:

Invested Assets

- C The reported value of the Company's Home Office exceeds the 10% of admitted assets limitation set forth by RCW 48.13.160(1). This occurred due to the substantial operating loss and corresponding decrease in reserves experienced during 1997. The portion of the value exceeding the limit should have been reported as a non-admitted asset by the Company. Subsequent to the examination date, the Company filed for and received from the Commissioner Special Consent Order No. 87, granting approval to include the entire value of the Home Office as an admitted asset.
- C The Company acquired property adjacent to the Home Office during 1995 with the intention of using it in the future as off site storage and employee parking. RCW

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- 48.13.160(3)(a) states that a company may invest its funds in real property requisite for its accommodation in the convenient transaction of its business, if approved by the Commissioner. The Company failed to seek approval from the Commissioner before acquiring the property. Subsequent to the examination date, the Company filed for and received from the Commissioner Special Consent Order No. 87, granting approval to include the value of the property as an admitted asset.
- C RCW 48.13.030 limits an insurer's investment in a single non-governmental entity to 4% of admitted assets, except with the consent of the Commissioner. The Company's investment in the Vanguard Index 500 Mutual Index Fund exceeds the 4% limit. The portion of the value exceeding the limit should have been reported as a non-admitted asset. Subsequent to the examination date, KPS liquidated all of its holdings of the Vanguard Index 500 Mutual Index Fund. (See Instructions No. 2).
- C Kitsap Physicians Service has placed its securities in the custody of one (1) bank and two (2) brokerage firms. A review of the safekeeping agreements notes that they do not include the required provisions for indemnifying the Company for lost securities and do not conform to the standards set forth by the NAIC. The securities in the custody of the two (2) brokerage firms do not comply with NAIC guidelines requiring custodians to be a bank, trust company or a security depository that is regulated by the Securities Exchange Commission and the Federal Reserve Board. (See Instructions No. 3).
- C The Company's Investment Policy includes two (2) clauses that could potentially place the Company in violation of certain provisions of Title 48 Revised Code of Washington (RCW).
- i. In regard to Asset Concentration, the policy states "No more than 10% of invested assets may be invested with any one issuer (other than the U.S. Treasury)" RCW 48.13.030 limits an insurer's investment in a single non-governmental entity to 4% of admitted assets.
 - ii. In regard to Trust Funds, the policy states "KPS maintains an indemnity fund as required by the State of Washington Insurance Department. These funds are controlled by KPS." This clause implies that KPS has exclusive control over the funds deposited in the indemnity fund. Although KPS maintains ownership of the deposits, the Depository Agreement states that the bank may not withdraw and distribute these deposits to the Company without joint written instructions from the Commissioner and the Company. The agreement does authorize the bank to distribute income from the deposits to the Company without joint written instructions.
- (See Recommendations No. 1).

Receivables and Other Assets

- C RCW 48.12.010(5) excludes premiums delinquent more than ninety (90) days as admitted assets. The KPS Uncollected Premiums account includes delinquent premiums that were not reported as non-admitted assets. (See Instructions No. 4).

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- C The Company's Electronic Data Processing Equipment asset account includes acquisitions of furniture, supplies, and office equipment as admitted assets. RCW's 48.12.010(11) and 48.12.020(5) expressly identifies furniture, furnishings, fixtures, equipment, stationery and supplies as non-admitted assets. (See Instructions No. 5).
- C The Company's Miscellaneous Receivables asset account includes receivables due from employee advances. RCW 48.12.020(3) expressly identifies advances to employees as a non-admitted asset. (See Instructions No. 7).

Liabilities

- C The January 1998 through March 1998 check registers include thirty-nine (39) invoices from 1997 that were not included in the Accounts Payable listing and not reported as a liability as of December 31, 1997. (See Instructions No. 8).
- C The liability for Other Expenses Due or Accrued included an accrual of \$241,854 which the Company identified as 'COB Savings Liability.' This accrual has been included in the liability for Other Expenses Due or Accrued since 1993 and has since remained unchanged. The Company could not provide supporting work papers for this accrual, which should have been written off in previous years. (See Instructions No. 9).
- C Receivables and payables relating to uninsured accident and health plans were netted together and reported as a negative receivable. The NAIC Annual Statement Instructions requires receivables and payables to be reported separately. (See Recommendations No. 2).

Reserves and Other Funds

- C The unrealized gains on stocks as reported in the Statement of Liabilities, Reserves & Other Funds does not agree with the unrealized gain on stocks as reported in Schedule D - Part 2 - Section 2. These amounts should agree per the NAIC Annual Statement Instructions.

Underwriting and Investment Exhibit - Part 4A

- C The Underwriting and Investment Exhibit - Part 4A included in the 1995, 1996 and 1997 Annual Statements did not accurately report the change in unrealized gain/(loss) in Column 5 - 'Net Gain Or (Loss) From Change In Difference Between Book And Admitted Values for Common Stocks'. The amount reported should equal the difference between the prior year unrealized gain/(loss) and the current year unrealized gain/(loss). (See Recommendations No. 3).

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INTERNAL SECURITY

Conflict of Interest

Kitsap Physicians Service has a Conflict of Interest policy that outlines in detail situations that may be considered a conflict of interest, procedures for identification of conflicts and the method for handling these situations. The policy requires new employees to receive a copy of the policy. All directors, officers and key employees are to annually sign a questionnaire stating they have reviewed the policy and are complying. The Board of Directors may appoint a committee of three persons to examine and review the questionnaire for conflicts. Specific recommendations are made to the Board.

Fidelity Bond and Other Insurance

The Company is a named insured on an extensive portfolio of insurance which appears to cover against all catastrophic and other losses. Coverage is provided by companies authorized and licensed in the State of Washington. The Company has Directors & Officers coverage and fidelity coverage. The NAIC suggested minimum amount of fidelity insurance is \$700,000 - \$800,000. The Company carries \$1,000,000 which exceeds the minimum guidelines.

The Fidelity and Deposit Company of Maryland

Employee Dishonesty Coverage	\$1,000,000
Deductible	2,500
Forgery or Alteration	5,000
Deductible	100
Profit Sharing Bond Employee Dishonesty	150,000

SAFECO Insurance Company of America

Location 1, Building 1	
Building	\$4,475,000
Deductible	1,000
Office Contents	2,000,000
Deductible	1,000
Extra Expense Restoration	150,000
Deductible	1,000
Coverage B & C	75,000
Deductible	1,000
Valuable Papers and Records	125,000
Deductible	1,000
Location 2, Building 1	
Office Contents	\$50,000
Deductible	1,000
Valuable Papers and Records	5,000
Deductible	1,000
Location 3, Building 1	
Office Contents	\$25,000

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Deductible	1,000
Location 4, Building 1	
Office Contents	\$100,000
Deductible	1,000
Valuable Papers and Records	25,000
Deductible	1,000
Location 5, Building 1	
Office Contents	\$10,000
Deductible	1,000
Location 6, Building 1	
Office Contents	\$5,000
Deductible	1,000
Commercial Liability Catastrophe Coverage	
General Aggregate Limit	\$2,000,000
Products - Aggregate Limit	2,000,000
Each Occurrence Limit	2,000,000
Self Insured Retention	10,000
Auto Liability	1,000,000
Executive Risk Indemnity, Inc.	
Directors and Officers Liability Insurance	\$5,000,000
Deductible	25,000
Managed Care Specific Excess Loss Insurance	1,000,000
Deductible	150,000
Executive Risk Specialty Insurance Co.	
Employment Practices Liability Insurance	\$1,000,000
Deductible	50,000
Errors and Omissions Liability	5,000,000
Deductible	25,000
St. Paul Fire & Marine Insurance Company	
Medical Professional Liability	\$1,000,000
Deductible	0
Westchester Fire Insurance Company	
Inland Marine - Earthquake and Flood Endorsements	\$6,725,000
Deductible	500,000

EMPLOYEE RELATIONS AND WELFARE

Kitsap Physicians Service offers to all employees and their families meeting certain eligibility requirements the following benefits at no cost to the employee:

Medical Coverage
Dental Coverage

Kitsap Physicians Service

Long Term Disability Insurance

Group Term Life and Accidental Death & Disability Insurance

Retirement Pension Plan

Kitsap Physicians Service offers a Retirement Pension Plan to eligible employees. The retirement plan is a Defined Benefit Plan designed to meet all Federal regulations contained in the Employee Retirement Income Security Act of 1974 (ERISA). The retirement plan is reviewed annually by an actuary. As of December 31, 1997, the actuary expressed an opinion that the actuarial assumptions are reasonable and represent the actuary's best estimate of the anticipated experience under the plan.

401(k) Savings Plan

Kitsap Physicians Service offers two (2) 401(k) Savings Plans to eligible employees: One (1) to the bargaining unit and one (1) to the non-bargaining unit. Employees may voluntarily defer from 1% to 15% of their salaries as contributions to the savings plans. KPS will match the first 3% of the non-bargaining unit employees' contributions. Employees are eligible to participate in the savings plan at age twenty-one (21) and become vested in the Company's contributions after two (2) years of service. Employees are always vested in their contributions.

Vacation Leave

Paid vacation leave is available to employees after six (6) full months of employment. Vacation leave accrues at a rate of 10/12 of a day per month. After six (6) months, the employee will have earned five (5) days vacation leave. After completing five (5) years of continuous service, the employee begins accruing fifteen (15) days per year. After ten (10) years of continuous service, the employee begins accruing twenty (20) days per year. Employees who have six (6) months or more service will be compensated for unused accumulated vacation credit upon termination. An accrual for vacation leave is included as a liability and appears to be reasonable.

Sick Leave

Paid sick leave is available to employees for personal illness, injury or other medical or dental reasons. Employees become eligible after three (3) months of service. Sick leave accrues at a rate of one (1) day per month. If an employee completes an entire calendar quarter without use of sick leave or leave without pay, the employee will be granted an additional day of pay. If an employee completes an entire calendar quarter using not more than one-half day of sick leave or leave without pay, the employee will be granted an additional one-half day of pay. Employees who have been continuously employed for five (5) years receive 50% of unused accrued sick leave pay in cash upon termination, provided the termination was not for misconduct and the employee provided two (2) weeks advance written notice. An accrual for sick leave is included as a liability and appears to be reasonable.

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TERRITORY AND PLAN OF OPERATIONS

The service area of Kitsap Physicians Service includes Jefferson, Kitsap, Mason and Thurston Counties.

During 1996 and 1997, KPS experienced net operating losses, substantially reducing its reserves by 56% from its 1995 level. The Company attributes these losses to extraordinarily high loss ratios on certain lines of business and higher administrative expenses. Realized losses on investments were also a contributing factor. In response to a request from the Commissioner, KPS submitted an operating plan for reversing its loss trend. The plan focuses on building premiums through reasonable and competitive premium rates, controlling claims experiences through a more economically efficient delivery system and sensibly managing administrative expenses.

EDP SYSTEMS AND OPERATIONS

The Management of KPS is sufficiently knowledgeable of EDP issues and provides direction and oversight through the Information Technology (IT) Steering Committee, which was implemented in January 1998. Systems Development, Acquisition and Maintenance Controls were evaluated to gain assurance that programs and systems are designed, tested, approved and implemented using appropriate controls. Due to the small size of the Company, there are numerous areas where procedures are not documented in writing. Financially-significant applications were acquired with appropriate documentation. The Director of Technical Service has been in his current position for less than one (1) year, and as he gets further settled in the position, written documentation will be implemented.

Operations and Application Controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and off-site storage facilities employed and the controls exercised to maintain data security. Adequate procedures and controls are in place for network operations, PC's and Year 2000 issues. The Company is on schedule for becoming Year 2000 compliant by mid-year 1999.

The Company does not have a Disaster Recovery Plan or a Business Contingency Plan that addresses the continuation of all significant business activities, including financial functions, telecommunication services and data processing services, in the event of a disruption of normal business activities. KPS is in the process of preparing these plans and anticipates having a contract for a recovery site by the end of 1998. (See Instructions No. 12 and 13).

GROWTH OF COMPANY

The following schedules reflect the growth of the Company by year beginning in 1995. The amounts shown were compiled from the Company's filed Annual Statements:

Kitsap Physicians Service

Schedule 1

	Admitted		
<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Reserves</u>
1997	\$33,864,080	\$24,854,643	\$9,009,437
1996	41,150,332	23,842,545	17,307,787
1995	45,058,681	24,368,031	20,690,650

Schedule 2

		Net	
<u>Year</u>	<u>Premiums</u> <u>Earned</u>	<u>Investment</u> <u>Gain</u>	<u>Underwriting</u> <u>Deductions</u>
1997	\$97,394,664	\$1,551,366	\$106,269,492
1996	97,635,572	2,060,889	104,113,360
1995	93,581,686	2,429,141	94,643,252

REINSURANCE

During the examination period, KPS was self reinsured. The funds in the Reinsurance Reserve Fund were held to cover large claims. During 1996, KPS experienced an increase in the number of large claims, exceeding the amount in the reserve fund and causing a debit balance of \$351,978. During 1997, the number of large claims decreased and the debit balance decreased to \$196,202.

Effective January 1, 1998, KPS discontinued the practice of self-reinsuring and entered into a reinsurance agreement with Executive Risk Indemnity, Inc. The reinsurance contract is a Managed Care Specific Excess Loss policy. The terms of the contract are as follows:

Insured Percentage: 90% for services provided by a participating provider, 80% for services provided by any other facility.

Maximum Benefit for each Covered Person per Policy Period: \$1,000,000.

Specific Retention Amount per Covered Person per Policy Period:

- a. \$150,000 with respect to Eligible Hospital Services provided by a Scheduled Hospital and
- b. \$100,000 with respect to Eligible Hospital Services provided by any other hospital.

Per Diem Rates for Scheduled and Other Hospitals:

- a. Scheduled Hospitals - \$3,000 average per diem maximum.
- b. Other Hospitals - \$4,000 average per diem maximum.

During 1998, KPS continues to allocate the same reinsurance charge per subscriber per month for reinsurance expenses. Each month, the cost of the reinsurance agreement with Executive Risk Indemnity, Inc. is deducted from the reinsurance charges. The remaining

Kitsap Physicians Service

balance is then applied to the debit balance carried forward from 1997, with the intent of recovering the deficit. At the end of 1998, after the debit balance has been recovered, KPS will determine the actual cost of reinsurance per subscriber and use an accrual closer to actual cost beginning in 1999.

SUBSEQUENT EVENTS

Order Granting Approval of Special Consent Investment No. 87 was issued on September 25, 1998 by the Office of Insurance Commissioner. The order formally approves the Company's ability to acquire and hold the following real estate investments:

- C Home office, in excess of ten percent of its admitted assets.
- C Fourth Street Apartments, acquired with the intent to be used as future home office off site storage and employee parking.

On November 12, 1998, KPS filed with the Office of the Insurance Commissioner an Amended 1997 Annual Statement. The amendment revised Pg. 3, Ln. 16 - 'Statutory Reserve' to \$4,984,450 from the previously reported balance of \$5,719,673. The amended 1997 Annual Statement was filed by KPS after the conclusion of the field audit work and was not reviewed by the examiners.

Subsequent to the examination date, KPS liquidated its entire investment in Vanguard Index 500 Mutual Index Fund. That investment was a focus of Instruction 2 of the examination report.

Subsequent to the close of field work, KPS retained Milliman & Robertson, Inc. (M&R) to review the current KPS liability on its deferred compensation plan, which is referenced in this examination report as "Deferred Compensation Plan - Fund A." M&R determined the total liability as of March 31, 1999, based on a 3.5% interest rate, to be \$337,067.

As part of its April 9, 1999 settlement of its request for a hearing in matter G 99-8, KPS agreed:

KPS will comply with chapter 48.13 RCW and will not assert in future administrative or judicial proceedings that it is not obligated to abide by chapter 48.13 RCW, unless a court of record, the Insurance Commissioner, or legislative enactment provides that chapter 48.13 RCW does not apply to health care service contractors. KPS will not bring or assert, directly or by appeal, any contention that chapter 48.13 RCW does not apply to it. For any financial reporting treatment of investments that requires approval or consent by OIC under chapter 48.13 RCW, OIC agrees that such approval or consent will not be unreasonably withheld.

Kitsap agrees these Plan obligations are accounted for as liabilities. KPS will have this obligation amount determined by a qualified actuarial opinion acceptable to OIC. These invested assets for the Plan must not be segregated and instead must be reported as one of the several components that make up "cash and invested assets." KPS will properly disclose these Plan obligations in a note to the financial statements. Plan obligations will be reported in the 1999 annual report and thereafter as an "aggregate write-in for other liabilities".

Kitsap Physicians Service

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Kitsap Physicians Service as of December 31, 1997:

Statement of Assets, Liabilities, Reserves and Other Funds
Underwriting and Investment Exhibit
Analysis of Examination Changes in Financial Statements
Comparative Statement of Assets, Liabilities, Reserves and Other Funds
Comparative Underwriting and Investment Exhibit
Five Year Reconciliation of Reserves and Unassigned Funds

The examination financial statements reflect the examination adjustments and reclassifications were required.

KITSAP PHYSICIANS SERVICE
Statement of Assets, Liabilities, Reserves and Other Funds
As of December 31, 1997

	Balance Per Company	Adj. No.	Examination Adjustments	Ref.	Balance Per Examination
ASSETS					
Bonds	\$ 7,210,496			Note 2	\$ 7,210,496
Stocks:					
Preferred stocks					-
Common stocks	3,897,029	(1)	(924,643)	Note 3	2,972,386
Mortgage loans on real estate:					
First liens	6,216				6,216
Real Estate:					
Properties occupied by the company	3,558,701			Note 4	3,558,701
Other properties	398,677				398,677
Cash	2,550,336			Note 5	2,550,336
Subtotals, cash and invested assets	17,621,455		(924,643)		16,696,812
Uncollected premiums	6,429,458	(2)	(5,164)		6,424,294
Amounts receivable relating to uninsured accident and health plans	(255,337)	(3)	411,517		156,180
Federal income tax recoverable and other refunds	2,059,143	(4)	(266,107)		1,793,036
Electronic data processing equipment	2,244,968	(5)	(47,620)		2,197,348
Interest and other investment income due and accrued	151,646				151,646
Other assets					
Aggregate write-ins for other than invested assets	5,612,747	(6,7)	(162,796)	Note 6	5,449,951
Total Assets	\$ 33,864,080		\$ (994,813)		\$ 32,869,267
LIABILITIES					
Claims unpaid	\$ 15,612,162			Note 7	\$ 15,612,162
Unpaid claims adjustment expenses	491,614				491,614
Unearned premiums	2,868,810				2,868,810
Taxes, licenses and fees due or accrued (excluding federal income taxes)	18,377				18,377
Other expenses due or accrued	2,228,024	(8)	(114,399)		2,113,625
Liability for amounts held under uninsured accident and health plans	-	(3)	411,517		411,517
Amounts withheld or retained for account of others	3,635,656				3,635,656
Aggregate write-ins for other liabilities	-	(10)	1,247,797		1,247,797
Total liabilities	24,854,643		1,544,915		26,399,558
RESERVES AND OTHER FUNDS					
Statutory reserve	5,719,673				5,719,673
Aggregate write-ins for reserves and other funds	2,813,571	(9,10)	(826,915)		1,986,656
Unassigned funds	476,193	(9,10)	(1,712,813)		(1,236,620)
Total reserves and unassigned funds	9,009,437		(2,539,728)		6,469,709
Total Liabilities, Reserves and Other Funds	\$ 33,864,080		\$ (994,813)		\$ 32,869,267

KITSAP PHYSICIANS SERVICE
Underwriting and Investment Exhibit
For the Year Ended December 31, 1997

	Balance Per Company	Adj. No.	Examination Adjustments	Ref.	Balance Per Examination
UNDERWRITING INCOME					
Premiums earned	\$ 97,394,664				\$ 97,394,664
Claims incurred	92,699,964				92,699,964
Expenses Incurred:					
Claim adjustment	1,679,022				1,679,022
Administrative	9,935,188	(8)	\$ (186,300)		9,748,888
Soliciting	<u>1,955,318</u>				<u>1,955,318</u>
Total underwriting deductions	<u>106,269,492</u>		<u>(186,300)</u>		<u>106,083,192</u>
Net underwriting gain or (loss)	(8,874,828)		186,300		(8,688,528)
INVESTMENT INCOME					
Net investment income earned	874,485			Note 8	874,485
Net realized capital gains or (losses)	<u>676,881</u>				<u>676,881</u>
Net investment gain or (Loss)	1,551,366		-		1,551,366
OTHER INCOME OR EXPENSE					
Aggregate write-ins for other income or expense	<u>(657,394)</u>			Note 9	<u>(657,394)</u>
Net gain or (loss) before federal income taxes	(7,980,856)		186,300		(7,794,556)
Federal income taxes incurred	<u>(1,928,870)</u>	(4)	<u>266,107</u>		<u>(1,662,763)</u>
Net Income or (Loss)	\$ (6,051,986)		\$ (79,807)		\$ (6,131,793)
RESERVES AND UNASSIGNED FUNDS					
Reserves and unassigned funds December 31, prior year	\$ 17,307,787				\$ 17,307,787
GAINS AND (LOSSES)					
Net gain or (loss)	(6,051,986)		\$ (79,807)		(6,131,793)
Net unrealized capital gains or (losses)	(1,442,589)				(1,442,589)
Change in non-admitted assets	(956,661)	(1,2,5,6,7,8)	(1,212,124)		(2,168,785)
Aggregate write-ins for changes to reserves and unassigned funds	<u>152,886</u>	(10)	<u>(1,247,797)</u>		<u>(1,094,911)</u>
Change in surplus as regards policyholders for the year	<u>(8,298,350)</u>		<u>(2,539,728)</u>		<u>(10,838,078)</u>
Reserves And Unassigned Funds December 31, Current Year	\$ 9,009,437		\$ (2,539,728)		\$ 6,469,709

KITSAP PHYSICIANS SERVICE
Analysis of Examination Changes in Financial Statements
As of December 31, 1997

	Adj. No.	INCREASE (DECREASE)
Reserves and unassigned funds, per Company		\$ 9,009,437
ASSETS		
Common stock	(1)	(924,643)
See Instructions No. 2		
Uncollected premiums	(2)	(5,164)
See Instructions No. 4		
Amounts receivable relating to uninsured accident and health plans	(3)	411,517
See Recommendations No. 2		
Federal income tax recoverable and other refunds	(4)	(266,107)
To adjust to actual refund due		
Electronic data processing equipment	(5)	(47,620)
See Instructions No. 5		
Aggregate write-ins for other than invested assets:		
Westsound Community Health Network	(6)	(155,989)
See Instructions No. 6		
Aggregate write-ins for other than invested assets:		
Miscellaneous Receivables	(7)	(6,807)
See Instructions No. 7		
LIABILITIES		
Liability for amounts held under uninsured accident and health plans	(3)	(411,517)
See Recommendations No. 2		
Other expenses due or accrued	(8)	114,399
See Instructions No. 8 and 9		
Aggregate write-ins for other liabilities	(10)	(1,247,797)
See Instructions No. 11b		
RESERVES AND OTHER FUNDS		
Aggregate write-ins for reserves and other funds	(9)	(343,460)
To adjust reported value of unrealized gain on stocks		
Unassigned funds	(9)	343,460
To adjust reported value of unrealized gain on stocks		
Net Increase/(Decrease) to Surplus		<u>(2,539,728)</u>
Reserves and unassigned funds, per Examination		\$ <u>6,469,709</u>

KITSAP PHYSICIANS SERVICE
Comparative Statement of Assets, Liabilities, Reserves and Other Funds
As of December 31,

	1997	1996
ASSETS		
Bonds	\$ 7,210,496	\$ 7,053,594
Stocks:		
Preferred stocks	-	2,500,000
Common stocks	2,972,386	12,139,993
Mortgage loans on real estate:		
First liens	6,216	31,271
Real Estate:		
Properties occupied by the company	3,558,701	3,516,981
Other properties	398,677	407,310
Cash	2,550,336	3,180,427
Subtotals, cash and invested assets	16,696,812	28,829,576
Uncollected premiums	6,424,294	6,132,903
Amounts receivable relating to uninsured accident and health plans	156,180	660,769
Federal income tax recoverable and other refunds	1,793,036	1,855,854
Electronic data processing equipment	2,197,348	287,668
Interest and other investment income due and accrued	151,646	150,223
Other assets	-	-
Aggregate write-ins for other than invested assets	5,449,951	3,233,339
Total Assets	\$ 32,869,267	\$ 41,150,332
LIABILITIES		
Claims unpaid	\$ 15,612,162	\$ 17,713,342
Unpaid claims adjustment expenses	491,614	611,148
Unearned premiums	2,868,810	534,066
Taxes, licenses and fees due or accrued (excluding federal income taxes)	18,377	89,339
Other expenses due or accrued	2,113,625	2,301,328
Liability for amounts held under uninsured accident and health plans	411,517	-
Amounts withheld or retained for account of others	3,635,656	2,593,322
Aggregate write-ins for other liabilities	1,247,797	-
Total liabilities	26,399,558	23,842,545
RESERVES AND OTHER FUNDS		
Statutory reserve	5,719,673	4,295,356
Aggregate write-ins for reserves and other funds	1,986,656	3,711,950
Unassigned funds	(1,236,620)	9,300,481
Total reserves and unassigned funds	6,469,709	17,307,787
Total Liabilities, Reserves and Other Funds	\$ 32,869,267	\$ 41,150,332

KITSAP PHYSICIANS SERVICE
Comparative Underwriting and Investment Exhibit
For the Years Ended December 31,

	1997	1996
UNDERWRITING INCOME		
Premiums earned	\$ 97,394,664	\$ 97,635,572
Claims incurred	92,699,964	91,789,089
Expenses Incurred:		
Claim adjustment	1,679,022	2,233,705
Administrative	9,935,188	8,011,370
Soliciting	1,955,318	2,079,196
Total underwriting deductions	<u>106,269,492</u>	<u>104,113,360</u>
Net underwriting gain or (loss)	(8,874,828)	(6,477,788)
INVESTMENT INCOME		
Net investment income earned	874,485	1,425,894
Net realized capital gains or (losses)	<u>676,881</u>	<u>634,995</u>
Net investment gain or (Loss)	1,551,366	2,060,889
OTHER INCOME OR EXPENSE		
Aggregate write-ins for other income or expense	<u>(657,394)</u>	<u>(702,837)</u>
Net gain or (loss) before federal income taxes	(7,980,856)	(5,119,736)
Federal income taxes incurred	<u>(1,928,870)</u>	<u>(1,825,478)</u>
Net Income or (Loss)	\$ <u>(6,051,986)</u>	\$ <u>(3,294,258)</u>

KITSAP PHYSICIANS SERVICE
Five Year Reconciliation of Reserves and Unassigned Funds
As of December 31,

	1997	1996	1995	1994
RESERVES AND UNASSIGNED FUNDS				
Reserves and unassigned funds December 31, prior year	\$ 17,307,787	\$ 20,690,650	\$ 18,305,249	\$ 15,617,966
GAINS AND (LOSSES)				
Net gain or (loss)	(6,131,793)	(3,294,258)	691,473	3,718,706
Net unrealized capital gains or (losses)	(1,442,589)	1,259,799	1,799,043	(537,131)
Change in non-admitted assets	(2,168,785)	(1,348,404)	(105,115)	(494,292)
Aggregate write-ins for changes to reserves and unassigned funds	(1,094,911)			
Change in reserves and unassigned funds for the year	(10,838,078)	(3,382,863)	2,385,401	2,687,283
Reserves And Unassigned Funds December 31, Current Year	\$ 6,469,709	\$ 17,307,787	\$ 20,690,650	\$ 18,305,249

Kitsap Physicians Service

NOTES TO THE FINANCIAL STATEMENTS

1. Accounting Policies

- A. Basis of presentation
The financial statements included herein have been prepared in accordance with accounting practices prescribed or permitted by the Office of Insurance Commissioner of the State of Washington and with the NAIC Financial Examiners Handbook.
- B. Investments
Investments are valued based on the NAIC's Valuation of Securities Manual. Bonds are valued using the straight-line method. Common stocks are valued at market value.
- C. Property, Furniture and Equipment
Buildings, office furniture and computer equipment are recorded at cost. Depreciation is computed on a straight line basis over the estimated life, forty (40) years for the building and five (5) years for furniture and equipment.
- D. Underwriting expense
Underwriting costs such as commissions and general insurance expense are written off in the year incurred and not deferred and amortized against future earning.
- E. Income Taxes
Taxable income differs from statutory income due to capitalization of policy acquisition expenses, discounting of policy reserves and utilization of net operating loss and tax carry forwards.
- F. Non-admitted assets
Certain assets designated as "non-admitted," which consist of furniture and equipment and prepaid expenses, have been excluded from the balance sheet. The non-admitted assets are reflected as direct adjustments from net worth. The audited total non-admitted assets as of December 31, 1996 amounted to \$5,136,131.

2. Bonds

Amortization of bond discounts and premiums is accrued using the effective interest method over the remaining term of the bonds. The statement value, unrealized gains and losses, estimated market values and acquisition cost of securities held for investment as of December 31, 1997 were as follows:

Kitsap Physicians Service

	Amortized Value	Unrealized Gains/ (Losses)	Market Value	Actual Cost
Government	\$5,541,815	\$(76,023)	\$5,617,838	\$5,498,719
States, Terr. & Poss.	507,449	(14,038)	521,487	506,090
Political Subdivisions	<u>1,161,232</u>	<u>(52,708)</u>	<u>1,213,940</u>	<u>1,164,042</u>
Total	<u>\$7,210,496</u>	<u>\$(142,772)</u>	<u>\$7,353,265</u>	<u>\$7,168,851</u>

The maturity distribution of all bonds owned as of December 31, 1997 was as follows:

	Amortized Value	Percent of Portfolio
Due in one year or less	\$1,030,362	14.3%
Due over one year through five years	4,415,036	61.2%
Due over five years through ten years	1,765,098	24.5%
Due over ten years through twenty years	0	0.0%
Over twenty years	<u>0</u>	<u>0.0%</u>
Total	<u>\$7,210,496</u>	<u>100.0%</u>

The Securities Valuation Office classification distribution as of December 31, 1996 was as follows:

	Amortized Value	Percent of Portfolio
Class 1	\$7,210,496	100.0%
Total	<u>\$7,210,496</u>	<u>100.0%</u>

3. Common Stocks

The Book Value, Unrealized Gains and Losses, Estimated Market Values and Actual Cost of common stocks held as of December 31, 1997 were as follows:

	Book Value	Unrealized Gains/ (Losses)	Market Value	Actual Cost
Common Stocks	\$2,401,091	\$1,495,938	\$3,897,029	\$2,401,091

4. Real Estate: Properties Occupied By The Company

Real Estate held for Company use consists of the home office building and investment property acquired for home office off site storage and employee parking. The Cost and Accumulated Depreciation as of December 31, 1997 were as follows:

Home Office at Cost	\$4,079,713
Accumulated Depreciation	<u>(521,011)</u>
Total Home Office Real Estate	<u>\$ 3,558,701</u>

Kitsap Physicians Service

Investment Real Estate at Cost	\$422,418
Accumulated Depreciation	<u>(23,741)</u>
Total Investment Real Estate	<u>\$ 398,677</u>

5. Cash

The reported balances for Cash and Short-Term Investments as of December 31, 1997 were as follows:

Cash	\$(214,321)
Short-Term Investments	<u>2,764,657</u>
Total Cash	<u>\$ 2,550,336</u>

6. Aggregate Write-Ins For Other Than Invested Assets

Aggregate Write-Ins For Other Than Invested Assets as of December 31, 1997 consisted of the following assets. These assets were properly reported as Non-Admitted Assets and the Balance Per Examination equals zero.

MDC	\$ 997
Deferred Comp. - Fund A	1,247,797
Westsound Community Health Network	290,998
Med Plus Receivable	1,743,323
Miscellaneous Receivable	<u>2,329,632</u>
Total reserve	<u>\$ 5,612,747</u>

7. Loss Reserves

Claims Unpaid had the following reserves for the year ending December 31, 1997:

Medical	\$15,535,247
Dental	<u>76,915</u>
Total Claims Unpaid Reserve	<u>\$15,612,162</u>

8. Net Investment Income

The following is a summary of net investment income earned for the year ending December 31, 1997:

Bonds	\$456,131
Common stock	106,147
Mortgage loans	1,740
Real estate	106,761
Cash on hand and on deposit	102,229
Short-term investments	91,092
Aggregate write-ins for investment income	<u>160,395</u>
Gross investment income	1,024,495

Kitsap Physicians Service

Investment expenses	<u>(150,010)</u>
Net Investment Income	<u>\$ 874,485</u>

9. Aggregate Write-Ins For Other Income or Expense

Aggregate Write-Ins For Miscellaneous Income as of December 31, 1997 consisted of the following item:

Fund A Reserve (Net)	\$(79,250)
Credentialing Service Net Income	(185,160)
Miscellaneous	(23,126)
High Risk Health Pool	(18,598)
Loss on Subsidiary	(61,036)
Legal Settlement & Fees	(170,780)
Loss on Equipment Disposal	<u>(119,444)</u>
Total	<u>\$(657,394)</u>

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Kitsap Physicians Service Company during the course of this examination.

In addition, acknowledgment is made of the participation in the work and preparation to this report by John R. Jacobson, AFE, Examiner-in-Charge; Kevin J. Thomas; all from the Washington Office of Insurance Commissioner.

Kitsap Physicians Service

AFFIDAVIT

STATE OF WASHINGTON }
 } ss
COUNTY OF THURSTON }

John R. Jacobson, AFE, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Kitsap Physicians Services was performed in a manner consistent with the standards and procedures required or prescribed by the Washington Office of Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

John R. Jacobson, AFE
Examiner-in-charge
State of Washington

Subscribed and sworn to before me this day of __, 1999.

Notary Public in and for the
State of Washington.